
FINDING AND RECOMMENDATIONS

FINDING: CONTRACT FUNDING

SYNOPSIS

Funds amounting to \$3.3 million that were legally appropriated and encumbered to cover the cost of fixed-price contracts within the DHS have, in some cases, been deobligated before the contract was completed. However, payments for services rendered under the subject contracts were made using a payment method known as “direct payments.” The contracted services continued even though, as required by regulation, the remaining portion of these contracts were not covered by an appropriated and encumbered (obligated) amount sufficient to assure full payment for such services. This occurred because officials made a conscious decision to pool and re-use the deobligated funds to pay for housing and other services for mentally retarded individuals mandated by the District courts. These court mandates require prompt payment to vendors in order to avoid fines and penalties. As a result, the DHS is technically in violation of the Anti-Deficiency Act (P.L. 93-344, Sec. 401 (a)) because instead of using other available expedited payment methods to promptly pay vendors, DHS deobligated funds on existing contracts without canceling the contracting documents that created the original obligations.

DISCUSSION

District of Columbia Municipal Regulation (DCMR) 27 requires that an appropriate amount of allocated budget authority be encumbered to cover the cost of a contract before the contract is executed. In addition, a contractor is not allowed to deliver supplies or perform services under any contract conditioned upon the availability of funds until the contracting officer has given written notice to the contractor that funds are available. In fact, upon learning that an executed contract is approaching the limit of the budget authority, the contracting officer is required to notify the contractor, in writing, that one of the following conditions exist:

- (a) That additional funding is available or the estimated cost has been increased in a specified amount;
- (b) That the contract will not be further funded, and that the contractor shall submit a proposal for an adjustment of fee, if any, based on the percentage of work completed in relation to the total work called for under the contract;
- (c) That the contract will be terminated; or
- (d) That the District is considering whether to allot additional funds or increase the estimated cost, that the contractor is entitled by the contract terms to stop work when the funding or cost limit is reached, and that any work beyond the funding or cost limit will be at the contractor’s risk.

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CONTRACTS AT THE DEPARTMENT OF HUMAN SERVICES

We found that during FYs 2001 and 2002, DHS had 182 active contracts purchase orders worth in excess of \$67 million. In addition, we found that 82 of the contracts purchase orders, valued in excess of \$20.4 million, were for MRDDA. We randomly chose 20 of those MRDDA contracts (19 contracts and 1 purchase order) worth about \$8.8 million for our review. The results of that review are shown below:

SCHEDULE OF MRDDA CONTRACTS REVIEWED						
CONTRACT NUMBER	NUMBER OF ENCUMBRANCES REVIEWED	NUMBER OF Number of Contracts with Encumbrances Partially Deobligated	DEOBLIGATIONS Number of Contracts with Encumbrances Totally Deobligated	FOUND Number with Both (2)	Unable to Verify (3)	No Deobligations Noted
JAACCS70019-05	4	1	1	1	1	
JAACCS70019-08	4	1	1	1		1
JAACCS70019-12	4		1	1		2
JAACCS70019-22	4			2	1	1
JAACCS70020-05	4	1	1	1	1	
JAACCS70020-07	4	1		2		1
JAACCS70020-10	4	1	1	1	1	
P/N 111995 (1)	1		1			
JAACCS99015-02	4				4	
JAACCS70022-01	4		2		1	1
JAACCS70019-04	4			3	1	
JAACCS70019-25	4	1	1		1	1
JAACCS70019-26	4		1		2	1
JAACCS70019-27	4	1	1		2	
JAACCS70019-11	4	1	2	1		
JAACCS70019-14	4		1	2		1
JAACCS70019-30	4	1	2	1		
JAACCS70020-08	4	1		2	1	
JAACCS70019-46	3	1			2	
JAACCS70019-48	4		1		2	1
Total	76	11	17	18	20	10
Contract Amount Subject to Encumbrance	\$ 8,795.7					
Deobligated (thousands)	\$ 3,345.9	\$ 280.1	\$ 1,238.4	\$ 1,827.4		

- (1) Purchase order number.
- (2) Encumbrance was partially deobligated at least once before being fully deobligated.
- (3) We could not verify the transaction because applicable documents contained no encumbrance code, or, encumbrance documents were missing.

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The above schedule shows \$3.3 million of the \$8.8 million in funds obligated for valid contracts was removed or deobligated from the contracts. In total, we identified 46 instances where DHS deobligated funds. We found that 11 of the 46 encumbrance actions had been partially deobligated during the contract period. Those 11 partial deobligation actions were valued in excess of \$280 thousand. In addition, 17 of the 46 encumbrance actions were totally deobligated before the contract was completed. The total deobligations were valued in excess of \$1.2 million and appeared in the District's financial system as canceled encumbrances. In addition, we found 18 of 46 instances where an encumbrance was being partially deobligated at least once before being totally deobligated. Deobligations in this category were in excess of \$1.8 million.

Results from the above review of 20 randomly selected MRDDA contract actions prompted us to request that officials query the District's FY 2001 and 2002 financial records for all deobligation actions occurring for encumbered contract purchase orders during that timeframe. While we did not verify the accuracy of the results of that request, the un-audited figures were quite revealing. The results showed that in FY 2001 a total of 646 deobligations of encumbered funds worth \$15 million occurred while 293 such actions worth \$15.5 million were shown for FY 2002. It should be noted that upon deobligation of the encumbered funds for each of the contracts in question, the DHS continued to use and order services from those contracts and made payments to contractors by employing a funding technique known as direct funding or direct payments.

DIRECT FUNDING/PAYMENTS

Direct funding or direct payments, as they are sometimes called, is a funding method usually reserved for non-procurement events. For example, it is used for court-ordered settlements and judgments, court-ordered fines, and other events not planned in advance. These payments are charged directly to the appropriated portion of the agency budget authority not allocated, reserved, or committed to any other procurement or expenditure.

The use of direct funding/payments by the DHS has occurred for several years and for many reasons. First, direct payments became popular when the District was required to pay about \$25 million in court fines because DHS had not satisfied vendor billings in a timely manner (see "Court Order" in Background Section). This type of payment was preferred when contractual agreements did not exist for services provided by court order. The processing time for direct payments is the same as for expedited voucher payments, between 2 and 14 days.

RE-DIRECTING FUNDS

Several lawsuits have been filed and won against the District on behalf of citizens and vendors who deal with the DHS. These lawsuits have resulted in Consent Orders/Decrees, which for example, require that citizens with mental retardation and/or developmental disabilities that were once housed in the Forest Haven Institution be placed at group homes

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operated by private vendors (Joy Evans Consent Order). Another requires juvenile justice reform by assuring that young offenders be provided the least restrictive setting possible while meeting the needs of the juvenile offender and protecting the public (Jerry M. Consent Decree). These Consent/Decree orders have had a tremendous affect on the DHS, which is responsible for assuring compliance, because any deviation from the letter of the Order/Decree or the lack of prompt payment to a vendor providing court ordered housing or services carry the threat of large fines. In fact, as stated above, the District has already been assessed fines for not meeting these prompt payment guidelines.

DHS officials admitted that funds were deobligated from existing contracts and made available for new court ordered contracts. This was done intentionally to assure the availability of funds for required contracts and to avoid any fines or penalties associated with a late payment to vendors involved in the subject contracts. DHS officials stated that they considered these actions necessary. However, despite the well-intentioned desire to promptly pay service vendors to avoid fines and penalties, DHS violated District financial policies and did not take advantage of expedited payment procedures.¹ Using expedited payment procedures would have satisfied the 30-day payment requirement and maintained the necessary fiduciary controls over contract funding.

DISTRICT OF COLUMBIA FINANCIAL POLICY

The Financial Policies and Procedures Manual (FP&PM), currently published in draft by the Office of the Chief Financial Officer (OCFO), gives guidance in section 4010.0 on accounting for and reporting on liabilities or obligations (accounts payable) incurred by the District of Columbia Government. This draft, in fact, elaborates on the previously discussed DCMR 27, which describes the District's established rules and procedures required to reduce encumbered dollars on standing contracts. The FP&PM draft manual describes the ramifications of deobligating funds on those contracts and could not be more clear when it states, at 4010.300D, "Once an obligation is approved, agencies may not de-obligate the funds unless they have canceled the documents creating the original obligation." The same reference goes on to state that "De-obligating funds in FMS in order to make available obligation authority for a new, separate obligation constitutes spending in excess of apportioned funds and is a violation of the Anti-Deficiency Act (P.L. 93-244, Sec.401 (a).)" DHS is responsible for ensuring compliance with the DCMR 27 and FP&FM once it becomes final. The Chief Financial Officer (CFO) has oversight, review and approval responsibility according to FP&PM 4010.400. We urge the CFO to move quickly to finalize this draft and assure that procurement officers understand the consequences of such deobligations as they relate to the Anti-Deficiency Act.

¹ Expedited payment procedures allows for the scheduling of vouchers for prioritized payment when the payment date is not less than 14 days from the agency CFO approval date. This process helps to ensure that the District continues to pay all vouchers against a purchase order or contract within good business terms.

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INTERNAL ACCOUNTING CONTROLS AND OVERSIGHT

Oversight policy such as DCMR 27 and the draft FP&PM are also important because they establish controls over the safeguarding of District assets against unauthorized acquisition, use, or disposition. They make information available to management needed to carry out its responsibilities related to prevention or timely detection of such unauthorized activities and provide mechanisms to enable management to monitor the continued effective operation of such controls.

Our review showed that while there were adequate policies and regulations in place to prevent the subject contract deobligations and redistribution of monies to other contracts, management did not have in place the internal controls required to recognize, report and investigate that prohibited practice. For example, we found that the CFO at DHS took unilateral action to deobligate fully and properly funded contracts. This was done without the knowledge of contracting officials responsible for the deobligated contracts. The establishment of effective contract oversight controls are needed at the CFO and DHS management levels to assure compliance with existing laws and regulations. These controls should require a signature authority by oversight officials before any money is moved from or between contracts and require that officials responsible for contracts at the DHS level be aware that monies are to be deobligated and that there are legitimate contractual actions predisposing an action to deobligate funds from the contract. Once it is determined that a contract will be cancelled, contracting officials must follow the contract termination policy as described by existing oversight policy. In addition, internal controls should be established to provide an audit trail to assure management that such contracts were correctly closed out and monies properly reassigned to higher priority projects.

RECOMMENDATION 1

We recommend that the Chief Financial Officer, Office of the Chief Financial Officer, determine if a violation of the Anti-Deficiency Act occurred and take appropriate action to rectify such a violation, to include personnel actions if deemed necessary.

RECOMMENDATION 2

We recommend that the Chief Financial Officer, Office of the Chief Financial Officer, finalize the draft Financial Policies and Procedures Manual and issue it in final version within 60 days.

RECOMMENDATION 3

We recommend that the Director, Office of Contracting and Procurement, establish supervisory oversight control procedures which will assure that contracts are not deobligated

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in order to move funds to another contract without using the proper procedures as outlined by the general accounting and contracting policies.

RECOMMENDATION 4

We recommend that the Director, Department of Human Services establish a level of oversight to assure that any deobligation of encumbered funds for contracts under his/her supervision occurs using the established and approved procedures as outlined in District approved accounting and contracting policies.

SUMMARY OF BENEFITS RESULTING FROM AUDIT

RECOMMENDATIONS	DESCRIPTION OF BENEFITS	AMOUNT AND TYPE OF BENEFIT
1	Compliance and Internal Controls. Implementation of performance standards will increase compliance with regulatory guidelines.	Nonmonetary.
2	Compliance and Internal Controls Implementation establishes policy for District agencies.	Nonmonetary.
3	Compliance and Internal Controls. Benefits arise from increased oversight.	Nonmonetary.
4	Compliance and Internal Controls. Benefits arise from increased oversight.	Nonmonetary.

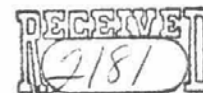
GOVERNMENT OF THE DISTRICT OF COLUMBIA
Office of Contracting and Procurement

Director



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September 23, 2003



Charles C. Maddox, Esq.
Inspector General
Office of the Inspector General
717 14th Street, NW, 5th Floor
Washington, DC 20005

Re: Audit of Procurement Activities By the Office of Contracting and Procurement
and the Department of Human Services

Dear Mr. Maddox:

Based on an audit conducted by the Office of the Inspector General (OIG) of procurement activities at the Department of Human Services, a draft report was forwarded to the Office of Contracting and Procurement (OCP) for review and comment. The report contained one major finding concerning the OCP: that District financial policies are being violated when funds on existing contracts are deobligated and redirected to other contracts. Included in this report were recommendations on how this problem could be corrected.

Although only Recommendation Number 3 (page 9 of the report) actually involves the direct participation of the OCP, it should be noted to truly curtail this practice there must be a symbiotic relationship between the OCP and the Office of the Chief Financial Officer (OCFO). At present, no contracts are entered into without certification from the OCFO that funding exists (notwithstanding requirement contracts). After funding has been encumbered and an award has been made, there can be no change to the total dollar amount unless there has been a contract modification duly accompanied by an additional certification from the OCFO. Violation of the District's financial policies occurs when attempts have been made to unilaterally deobligate funds without the input of the OCP.

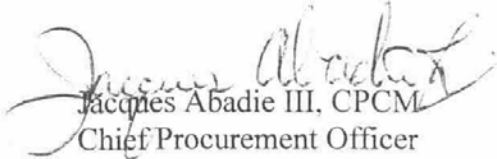
This office concurs with the posture of the OIG that controls must exist to ensure that contracts are not deobligated to move funds from one contract to another. However, the OCP is of the opinion that the best safeguard against violation of financial policies regarding contract funding is when both the OCP and the OCFO collaborate on any deobligation.

One way to accomplish this objective is to supplement the proposed language addressing deobligations in the draft Financial Policies and Procedures Manual (Page 8 of audit, second full paragraph) to require the direct involvement of the OCP. The proposed language should be amended to reflect the following: "Once an obligation is approved, agencies may not deobligate the funds unless OCP has modified the contract to reflect the amount to be deobligated." The two respective offices working together should preclude any further violations of the District's financial policies regarding contract funding.

Charles Maddox
September 23, 2003
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Should additional information be necessary regarding the comments of this office, please contact
Agency Contracting Officer for the Department of Human Services, he can be reached on
(202) 279-

Sincerely,


Jacques Abadie III, CPCM
Chief Procurement Officer